On Wednesday, December 5, the Committee held a hearing to examine the role played by compensation consultants in determining the pay packages of senior executives at the largest publicly trade corporations. Corporate governance experts, institutional investors, and compensation consulting firms testified regarding the role of consultants in setting executive pay, efforts to prevent and manage conflicts of interest, and the adequacy of disclosures to shareholders regarding the role of consultants. A preliminary transcript of this hearing is now available on the Committee website. During the hearing, Chairman Waxman released a report regarding conflicts of interest at executive compensation consulting firms.

Recommendations of Corporate Governance Experts. Outside pay advisors can have an enormous impact on executive pay. When they do their job right, they can align the interests of the CEO with the interests of the shareholder. When they do their job poorly, however, the result can be enormous executive pay packages with no relationship to performance.

At the hearing, corporate governance experts emphasized that it is important that pay consultants be free of conflicts of interest. Professor Charles Elson from the John L. Weinberg Center for Corporate Governance at the University of Delaware testified that as a matter of best practice, corporate boards should directly hire any consultants working for the compensation committee and that these consultants should do no other work for the company or its management. Professor Elson noted that this approach has been endorsed by numerous business and investor groups, including the National Association of Corporate Directors. Other experts testifying at the hearing, including large institutional investors from the Connecticut State Treasurer’s Office and the AFL-CIO, echoed Professor Elson’s view regarding the importance of independent consultants.

Testimony of Pay Advisors. The Committee also heard from several consultants, including both “diversified firms — consultants that provide other services in addition to compensation advice — and independent firms that only do compensation work for the Board of Directors. The diversified consultants emphasized that they have internal policies in place to ensure that pay consultants are not influenced by other, often more lucrative work being done for their corporate clients. The independent consultants responded that based on their experience, internal policies do not, in fact, alleviate conflicts.

The Committee Report. At the request of Chairman Waxman, Committee staff examined the question of whether the compensation consultants hired by large publicly traded companies have financial conflicts of interest. To assist with its analysis, the Committee obtained nonpublic information regarding the fees earned by the leading compensation consulting firms for executive pay advice and others services (e.g., actuarial services, benefits administration).

The report — which was released at the hearing — concluded that (1) compensation consultant conflicts of interest are pervasive; (2) the fees earned by compensation consultants for providing “other services often far exceed those earned for advising on executive compensation; (3) many Fortune 250 companies do not disclose their compensation consultants’ conflicts of interest; and (4) there appears to be a correlation between the extent of a consultant’s conflict of interest and the level of CEO pay.